

Message Text

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SUBJECT: EDRC ANNUAL REVIEW OF YUGOSLAVIA, MARCH 12

REF: (A) USOECD 6017; (B) BELGRADE 1111;

(C) CLARK-GERVERS TELCON MARCH 10; (D) OECD DOCUMENT

EDR(75)5

1. SUMMARY: EDRC REVIEW OF YUGOSLAVIA PRODUCED LIVELY DISCUSSION AND STRONG DIVERGENCE OF OPINION ON OUTLOOK FOR EMPLOYMENT, INFLATION AND EXPORTS. ON EMPLOYMENT, EDRC FELT THAT THREE PERCENT PROJECTED GROWTH RATE IN 1975 WOULD BE INSUFFICIENT TO ABSORB NEW ENTRANTS TO LABOR FORCE AS WELL AS RETURNING MIGRANT WORKERS. ON INFLATION, EDRC CONSIDERED THAT YUGOSLAVIA SHOULD GIVE GREATER ATTENTION TO ANTI-INFLATION MEASURES TO AVOID LOSING EXPORT COMPETITIVENESS. ON EXPORTS, EDRC CONSIDERED 10 PERCENT VOLUME GROWTH TARGET TO BE UNATTAINABLE IN PRESENT CIRCUMSTANCES OF WORLDWIDE ECONOMIC RECESSION. YUGOSLAV DEL (LED BY DR. COLONOVIC, LIMITED OFFICIAL USE

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GOVERNOR, NATIONAL BANK OF YUGOSLAVIA) THOUGHT THAT

EXPECTED CURRENT ACCOUNT DEFICIT OF \$900 MILLION COULD BE FINANCED WITHOUT DIFFICULTY IN 1975 AND THAT THERE WOULD BE NO DANGER OF DEBT SERVICING PROBLEMS. END SUMMARY

2. OUTPUT AND DEMAND: YUGOSLAV DEL EXPECTS SOCIAL PRODUCT TO RISE SIX PERCENT IN 1975 AFTER EIGHT PERCENT INCREASE IN 1974 (HIGHEST IN OECD). ONE POSSIBLE CONSTRAINT ON 1975 GROWTH MAY BE ELECTRIC POWER SHORTAGES WHICH WILL BE TWICE AS LARGE AS FORESEEN WHEN DRAWING UP 1975 OUTPUT TARGETS. NEVERTHELESS, YUGOSLAVS STILL BELIEVE TARGET GROWTH RATE OF SIX PERCENT IS ACHIEVABLE. (SECRETARIAT THINKS THIS IS OPTIMISTIC ASSUMPTION.) INVESTMENT OUTLOOK REMAINS STRONG WITH SEVEN PERCENT REAL INCREASE EXPECTED IN 1975. PROBLEMS OF ILLIQUIDITY AT ENTERPRISE LEVEL ARE TO BE RESOLVED BY MORE LIBERAL BANK CREDIT POLICY AND INTRODUCTION OF NEW SYSTEM OF ENTERPRISE INCOME ACCOUNTING. LATTER INVOLVES CHANGE IN GROSS INCOME AVAILABLE FOR DISTRIBUTION (AS WAGES OR ENTERPRISE EARNINGS FOR INVESTMENT) BY USING CASH SALES AS BASIS FOR CALCULATIONS INSTEAD OF INVOICE SALES. RECENT ILLIQUIDITY HAS BEEN PARTLY DUE TO HIGH LEVEL OF INVESTMENT, THUS NEW INCOME DISTRIBUTION MEASURES MAY OBLIGE ENTERPRISES TO OPERATE MORE CLOSELY IN LINE WITH AVAILABLE CASH FLOW, AND POSSIBLY HAVE EFFECT OF DAMPENING FIXED INVESTMENT AS WELL AS RESTRAINING WAGE GROWTH. SECRETARIAT NOTES THAT NEW SYSTEM OF INCOME DISTRIBUTION UNLIKELY HAVE MUCH IMPACT BEFORE 1976.

3. PRICES AND WAGES: EDRC VIEWED YUGOSLAV TARGET OF TWO PERCENT REDUCTION IN INFLATION RATE FROM 25 PERCENT LEVEL OF 1974 TO BE EXTREMELY MODEST. SEVERAL DELS EXPRESSED VIEW THAT REFDOC WAS ALTOGETHER TOO COMPLACENT ABOUT NEED FOR CONTROLLING INFLATION, AND THAT MORE EMPHASIS SHOULD BE PUT ON STABILIZATION POLICY, ESPECIALLY IN VIEW OF NEED TO MAINTAIN EXPORT COMPETITIVENESS. THERE WAS SOME CONFUSION REGARDING INFLATION MECHANISM IN YUGOSLAVIA, WHERE ONLY FORTY PERCENT OF PRICES FOR GOODS AND SERVICES ARE SET BY LIMITED OFFICIAL USE

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MARKET FORCES. YUGOSLAVS NOTED THAT USUAL CONCEPTS OF DEMAND-PULL AND WAGE-PUSH INFLATION DO NOT APPLY, AND THAT LARGE PORTION OF DOMESTIC INFLATION IS IMPORTED. SECRETARIAT RESPONDED THAT YUGOSLAV INFLATION RATE CONSIDERABLY WORSE IN 1974 THAN IN MOST OTHER OECD COUNTRIES WHO WERE SIMILARLY FACED WITH HIGH IMPORT PRICES, AND THAT TWO PERCENT REDUCTION IN INFLATION RATE WAS NOT MUCH IN VIEW OF RECENT SHARP DOWNTURN IN

IMPORT PRICES. GERMAN AND U.S. DELS CITED EPC CONCLUSION THAT DEFICIT COUNTRIES SHOULD FOLLOW POLICIES OF DOMESTIC RESTRAINT AND WAIT FOR EXTERNAL IMPULSE TO REINVIGORATE ECONOMIES, CONCENTRATING IN MEANTIME ON INFLATION CONTROL TO IMPROVE EXPORT COMPETITIVENESS. YUGOSLAVS REPLIED THAT NEGLECTING GROWTH WAS NOT AN ACCEPTABLE POLICY FOR RESTRAINING INFLATION.

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4. EMPLOYMENT: EDRC WAS EXTREMELY DUBIOUS ABOUT YUGOSLAV CLAIMS THAT PROJECTED 3 PERCENT GROWTH OF EMPLOYMENT WOULD BE SUFFICIENT TO ABSORB NEW ENTRANTS INTO LABOR FORCE AS WELL AS RETURNING MIGRANT WORKERS. YUGOSLAV DEL CLAIMED THAT DECLINING RATE OF GROWTH OF LABOR FORCE (DUE TO DEMOGRAPHIC FACTORS) WOULD ADD ONLY 90,000 NEW ENTRANTS TO SOCIAL SECTOR LABOR FORCE, AND EVEN IF RETURNING MIGRANTS WERE 50,000 (OFFICIAL PROJECTION IS 30,000), THIS WOULD BE WITHIN

EXPECTED GROWTH OF SOCIAL SECTOR EMPLOYMENT OF 150,000 PEOPLE. MOREOVER, MANY RETURNING MIGRANTS WOULD NOT ENTER SOCIAL SECTOR BUT INSTEAD USE ACCUMULATED SAVINGS TO SET UP SHOPS IN PRIVATE SECTOR OR ELSE RETURN TO FARMS. MOST EDRC DELS AND SECRETARIAT WERE SKEPTICAL ABOUT RETURN OF INDUSTRIAL MIGRANT WORKERS TO LAND AFTER SAVORING DELIGHTS OF MODERN SOCIETY. U.S. DEL CAST DOUBT ON YUGOSLAV EMPLOYMENT FIGURES BY NOTING AVERAGE ANNUAL GROWTH OF LABOR FORCE OF 125,000 (TABLE 3 REFD0C), PLUS AVERAGE ANNUAL OUTFLOW OF 75,000 TO LIMITED OFFICIAL USE

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GERMANY ALONE, PLUS RETURNEES OF 50,000 GIVES POTENTIAL INCREASE OF UP TO 250,000 JOB SEEKERS IN 1975. SECRETARIAT WEIGHED IN BY NOTING THAT EMPLOYMENT GROWTH IS USUALLY UNDERESTIMATED AND WAS 6 PERCENT IN 1974. YUGOSLAV DEL AGREED TO REFLECT ON THESE POINTS.

5. EMPLOYMENT POLICY: SECRETARIAT AND SEVERAL EDRC DELS SUGGESTED THAT YUGOSLAV PRODUCTION FUNCTION WAS OUT OF BALANCE WITH EXCESSIVE EMPHASIS ON INCREASE IN PRODUCTIVITY VIA INTRODUCTION OF CAPITAL INTENSIVE MODERN TECHNOLOGY. EMPLOYMENT PROBLEMS COULD PERHAPS BE ALLEVIATED BY ACCEPTING SLIGHTLY LOWER GROWTH OF PRODUCTIVITY, PERHAPS BY INCREASED INVESTMENT IN HOUSEBUILDING. YUGOSLAVS REJECTED BOTH THE ASSUMPTION AND THE SOLUTION, SAYING THAT MODERN TECHNOLOGY WAS ESSENTIAL TO MAINTAIN INTERNATIONAL COMPETITIVENESS, AND IF ANY INCREASE IN EMPLOYMENT WAS TO BE ACHIEVED, IT WOULD BE THROUGH INCREASED INVESTMENT IN BASIC INDUSTRY, NOT HOUSEBUILDING. THEY DENIED IN ANY CASE THAT ADDITIONAL JOB CREATION WOULD BE NECESSARY, AND THEY NOTED THAT SHIFTS TO HOUSEBUILDING WOULD BE DIFFICULT BECAUSE OF SHORTAGES OF CONSTRUCTION MATERIALS. EFFORTS WOULD CONTINUE, HOWEVER, TO INCREASE INVESTMENT IN AGRICULTURE VIA GREEN PLAN AND CONTINUATION OF PREFERENTIAL CREDIT SCHEME. THIS WOULD MAKE AGRICULTURE MORE ATTRACTIVE TO RETURNING MIGRANTS.

6. BALANCE OF PAYMENTS OUTLOOK: YUGOSLAVS SEE IMPROVEMENT IN CURRENT ACCOUNT DEFICIT FROM \$1.15 BILLION IN 1974 TO \$900 MILLION IN 1975. IMPORTS WILL BE LOWER BECAUSE OF LARGE RAW MATERIAL RESERVES BUILT UP IN 1974 AND BETTER OUTLOOK FOR DOMESTIC FOOD PRODUCTION. EXPORTS EXPECTED TO RISE BY 10 PERCENT IN VOLUME TERMS DUE TO (1) GREATER AVAILABILITY OF EXPORT CREDITS IN INDUSTRIAL COUNTRIES, (2) INTRODUCTION OF CENTRAL BANK FACILITIES FOR DISCOUNTING 80 PERCENT OF EXPORT PAPER, (3) INCREASED EXPORTS TO OPEC AND LDC'S (ESPECIALLY INFRASTRUCTURE

PROJECTS), AND (4) GROWING CONVERTIBLE CURRENCY SALES TO EASTERN EUROPEAN MARKETS. OUTLOOK FOR INVISIBLES REMAINS POSITIVE, WITH INCREASED EARNINGS FROM LIMITED OFFICIAL USE

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CONSTRUCTION CONTRACTS IN LDC'S, STRONGER PERFORMANCE OF TOURISM, AND CONTINUED GROWTH OF WORKERS' REMITTANCES (FROM \$1.6 BILLION IN 1974 TO \$1.75 BILLION IN 1975).

7. PROSPECTS FOR WORKER REMITTANCES AND EXPORTS: U.S. DEL CHALLENGED FIGURE FOR REMITTANCES BY NOTING UNFAVORABLE PROSPECTS FOR MIGRANT WORKER EMPLOYMENT IN WESTERN EUROPE. YUGOSLAVS REMAINED COMPLETELY CONFIDENT THAT PROJECTED FIGURE COULD BE REACHED BY ACTIVE EFFORTS OF YUGOSLAV BANKS ABROAD TO CHANNEL SAVINGS HOME, PLUS OTHER (AS YET UNSPECIFIED) MEASURES WHICH WILL BE INTRODUCED TO ENCOURAGE MIGRANT WORKER SAVINGS. EDRC ALSO VERY DOUBTFUL ABOUT YUGOSLAVIA'S CHANCES OF ACHIEVING 10 PERCENT GROWTH TARGET FOR EXPORTS. U.S. DEL POINTED OUT THAT OECD IMPORTS ARE EXPECTED TO RISE LESS THAN 1 PERCENT IN 1975; AND NON-OIL LDC'S IMPORTS HAVE BEEN PREDICTED BY OECD TO FALL BY 8 PERCENT. MOREOVER, YUGOSLAV INFLATION RATE WOULD BE HIGHER THAN MOST OF ITS COMPETITORS AND MIGHT CAUSE DECLINE IN EXISTING MARKET SHARES. SECRETARIAT AND OTHER DELS AGREED THAT EXPORT TARGETS NOT VERY REALISTIC.

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8. FINANCING OF CA DEFICIT: YUGOSLAVS WERE CONFIDENT THAT PROJECTED CA DEFICIT OF \$900 MILLION COULD BE FINANCED COMFORTABLY IN 1975 AND THAT DEBT SERVICE RATIO COULD BE HELD WITHIN TARGET LEVEL OF 15 PERCENT. YUGOSLAVS WILL LOOK TO IMF OIL FACILITY, INTERNATIONAL CAPITAL MARKETS (\$240 MILLION), SPECIAL B/P FINANCING ARRANGEMENTS WITH GERMANY, OIL DELIVERIES ON CREDIT FROM IRAQ, AND POSSIBLE FURTHER DIRECT BORROWINGS FROM KUWAIT, ABU DHABI OR LIBYA TO FINANCE CA DEFICIT. IF DEFICIT IS LARGER THAN ANTICIPATED, FOREIGN EXCHANGE RESERVES OF \$1.5 BILLION PROVIDE ADEQUATE CUSHION AGAINST DEBT SERVICING DIFFICULTIES.

9. FOREIGN INVESTMENT: U.S. DEL ASKED WHY U.S. INVESTMENT IN JOINT VENTURES HAD BEEN SO LOW (REF C), AND WAS TOLD THAT THIS WAS DUE TO LACK OF FAMILIARITY WITH YUGOSLAV CONDITIONS AND SOME RESIDUAL RESISTANCE IN YUGOSLAVIA TO FOREIGN INVESTMENT. DESPITE OPIC INVESTMENT INSURANCE, U.S. COMPANIES HAD BEEN SLOW TO LIMITED OFFICIAL USE

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TAKE INITIATIVE, WHEREAS EUROPEANS (ESPECIALLY BRITISH) HAD BEEN MORE ENTERPRISING. YUGOSLAVIA CURRENTLY CONSIDERING POSSIBILITY OF ENLARGING NUMBER OF SECTORS IN WHICH FOREIGN ENTERPRISE WOULD BE WELCOME, BUT NO DETAILS YET AVAILABLE.
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